

**Actions to Develop Goals and Standards
and Upgrade the Management Information
System for the Innocent Spouse Program
Have Not Been Fully Implemented**

September 2001

Reference Number: 2001-40-162

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

September 27, 2001

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION
COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

A handwritten signature in cursive script, reading "Pamela J. Gardiner".

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Report - Actions to Develop Goals and Standards and
Upgrade the Management Information System for the Innocent
Spouse Program Have Not Been Fully Implemented

This report presents the results of our review to evaluate how effectively the Internal Revenue Service (IRS) has implemented prior recommendations to set goals and standards for the Innocent Spouse Program (ISP) and upgrade the management information system.

In summary, we found that management has not yet set sufficient program goals and standards to fully measure and report accomplishments of the ISP; and the management information system, while improved, still contains some significant weaknesses.

We recommended that the IRS develop a formal program letter for the ISP to direct program resources and establish criteria to measure program accomplishments. At the same time, controls need to be strengthened to ensure the management information system provides accurate information for use by management. Management initiated some corrective actions in March 2001, and is considering additional actions.

While IRS management agreed with our recommendations and will initiate corrective actions, they did take issue with several comments made in our report regarding issues such as inventory status and age. In their response, they detailed their view of these issues. Management's comments have been incorporated into the report where appropriate, and the full text of their comments is included as an appendix.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or

M. Susan Boehmer, Acting Assistant Inspector General for Audit (Wage and Investment Income Programs), at (770) 936-4590.

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Executive Summary

The Congress passed the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (RRA 98)¹ in part to address concerns about protecting the innocent spouse who signed a joint return without knowledge of specific items on the return, and became personally liable for the errors of the other spouse. The IRS Commissioner considered the provisions for innocent spouse relief to be 1 of the 10 most significant areas of the legislation.

In May 2000, the Treasury Inspector General for Tax Administration (TIGTA) issued an audit report on the Innocent Spouse Program (ISP)² which stated that the IRS was not prepared to effectively process the increased volume of claims for innocent spouse relief that were received after the passage of the RRA 98. The report recommended that the IRS set goals and standards for the ISP, upgrade the Innocent Spouse Tracking System (ISTS) that serves as the primary management information system, and incorporate additional controls into the ISP that address quantity, cost, and timeliness of the program. The objective of this review was to evaluate how effectively the IRS has implemented the specific recommendations to set goals and standards for the ISP and upgrade the management information system.

Results

Since our earlier review, the IRS has taken steps to implement corrective actions that we previously recommended. However, additional actions need to be taken to formalize goals and standards, and additional controls need to be implemented to ensure the accuracy of the ISTS. The ISP has made significant progress – especially at the Central Site. The Central Site at the Cincinnati Service Center (CSC) has grown to over 145 full-time and 35 temporary employees under the direct line authority of the ISP Manager. Unfortunately, the same degree of progress has not been made in completing claims assigned to Small Business/Self-Employed (SB/SE) personnel in the field.

Some of the more significant achievements include the following:

- Accurately date stamping and recording received dates on claims.

¹ The Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685.

² *Increased Attention is Needed to Ensure Timely, Accurate Determinations on Innocent Spouse Claims for Relief* (Reference Number 2000-40-063, dated May 18, 2000).

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- Properly receiving, controlling and shipping returns from the CSC Central Site to field office examiners.
- Designing a computer application to enhance the quality of casework and accelerate the determinations on claims at the CSC Central Site.
- Developing an automated system of reporting data from the ISTS for use by all managers.
- Updating features on the ISTS that simplify input and improve the quality of data.
- Refining the model used to project future inventory levels. This occurred several times to compensate for increased claim receipts and decreased closures.

While the IRS has made these improvements, corrective actions have not been fully implemented. Management still needs to formalize comprehensive program goals and standards to fully measure and report accomplishments of the program. The inventory of claims continues to grow and old claims remain in inventory. Also, the ISTS, while improved, needs additional controls to ensure that it is properly implemented. This is particularly true in SB/SE field units that are not under the direct control of the ISP Manager.

A Comprehensive Set of Goals and Standards Has Not Been Formalized and Developed for the Innocent Spouse Program

Management has not placed enough emphasis on setting goals and standards for the ISP. The effect of not having comprehensive goals and standards for the ISP can be seen in the inventory of claims for relief. Since the RRA 98 liberalized the innocent spouse provisions, receipts of claims for relief have increased dramatically and continue to exceed projections. The ISP Manager stated that they were making progress on reducing the number of taxpayers who have not yet been notified of the disposition of their claims. However, as of December 24, 2000, there were 66,741 claims for relief in open inventory. This is a significant increase over the approximately 46,000 claims in inventory as of December 31, 1999. In addition to the number of claims getting larger, the claims also remain in inventory longer. Thirty-nine percent of the claims had been in inventory between 1 and 2 years, and 5 percent had been in inventory longer than 2 years.

Not having adequate goals and standards has made it difficult to properly manage the ISP. It is even more difficult to manage SB/SE resources used to evaluate claims because the ISP Manager does not have direct control over those resources. As a result, significant inventory backlogs continue, program resources may not be properly directed, program accomplishments may not be accurately measured, and program results may not be accurately reported to the IRS Commissioner and to the Congress. At the same time, taxpayers' total liabilities are increased because penalties and interest continue to accrue

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while the claim is being considered. The longer it takes to work the claim, the greater the resulting tax liability.

Small Business/Self-Employed Field Personnel Have Not Properly Implemented the Innocent Spouse Tracking System

We reviewed 250 randomly selected innocent spouse claims and determined that 20 percent were either not properly updated in the ISTS or were not accurately reflected in reports generated from the ISTS. However, the ISTS accurately reflects the total number of claims received and has the ability to generate numerous reports. Most of the errors in the ISTS were on cases assigned to field examiners in the SB/SE business unit. The CSC Central Site more accurately maintains its segment of the ISTS and uses the management information generated from the ISTS.

Several factors contributed to the inaccuracies in the ISTS. First, management had not developed adequate inventory controls. Second, the inventory controls that had been developed were not properly implemented. Third, field managers relied primarily on traditional Examination inventory controls such as the Audit Information Management System (AIMS) and the Examination Returns Control System (ERCS) instead of the ISTS.

As a result, the ISTS did not provide accurate information on the status and location of claims assigned to the field, and SB/SE managers were not using the ISTS to effectively manage inventory and resources. Also, the ISP Manager did not receive accurate information to update the inventory model or to evaluate and report program results to the IRS Commissioner and to the Congress.

Summary of Recommendations

IRS management needs to continue to follow through with the corrective actions stated in the response to our original report. Accordingly, we recommend that the IRS develop a formal program letter for the ISP to direct program resources and measure program accomplishments. At the same time, controls need to be strengthened over the management information system to ensure that it provides timely, accurate information that is used by management. Management initiated some corrective actions in March 2001, and is considering additional actions.

Management's Response: The Wage and Investment (W&I) Division Strategy and Program Plans contain goals and measures for personnel resources applied and determinations made for innocent spouse claims. Target levels of pre- and post-determination inventories are a fundamental part of developing these goals and measures. The IRS is committed to monitoring these inventories and will evaluate and revise these standards semiannually. In addition, the Project Office, in partnership with SB/SE and

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the CSC Central Site, will provide specific guidance for conducting inventory validations in the multi-functional Innocent Spouse section of the Internal Revenue Manual. The IRS also made the computer-based ISTS training universally and easily available for download from the W&I Electronic Learning System.

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Objective and Scope

This review was designed to evaluate previous recommendations to set goals and standards for the ISP and upgrade the management information system.

The objective of this review was to evaluate how effectively the Internal Revenue Service (IRS) implemented the corrective actions recommended in a previously issued report on the Innocent Spouse Program (ISP).¹ Our earlier report recommended the following:

1. Set goals and standards for the ISP.
2. Upgrade the current management information system (MIS) and ensure that it provides complete, accurate, and useful feedback.
3. Design and implement a system of internal controls that addresses the quantity, cost, and timeliness of the ISP to complement the existing controls over the quality of the Program.

This report specifically addresses the actions taken to correct the two recommendations dealing with setting goals and standards and upgrading the MIS.

We performed the review in the IRS National Office, the Innocent Spouse Central Site at the Cincinnati Service Center (CSC), and four field offices (Cincinnati, Los Angeles, Phoenix, and Richmond), between July and December 2000. The review was performed in accordance with *Government Auditing Standards*. Details of the audit objective, scope, and methodology are presented in Appendix I. Major contributors to this report are listed in Appendix II.

¹ *Increased Attention is Needed to Ensure Timely, Accurate Determinations on Innocent Spouse Claims for Relief* (Reference Number 2000-40-063, dated May 18, 2000).

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Background

The RRA 98 liberalized the provisions for innocent spouse relief.

The Congress passed the IRS Restructuring and Reform Act of 1998 (RRA 98)² in part to address concerns about protecting the innocent spouse who signed a joint return without knowledge of specific items on the return and became personally liable for the errors of the other spouse. This became more critical if the taxpayers divorced and the innocent spouse was the best source for collecting the unpaid tax. In effect, the legislation liberalized the ISP provisions and made it easier to file a claim and qualify for relief as an innocent spouse. The IRS Commissioner considered the provisions for innocent spouse relief to be 1 of the 10 most significant areas of the legislation.

In May 2000, TIGTA issued an audit report on the ISP which stated that the IRS was not prepared to effectively process the increased volume of claims for innocent spouse relief that were received after the passage of the RRA 98. IRS management had not reacted to predictions of significant increases in the number of claims that would be filed and was slow to increase staffing when the predicted number of claims was received. Also, management did not set goals for the ISP and did not have an adequate MIS to measure program accomplishments.

The IRS has taken steps to implement corrective actions that we previously recommended. However, additional actions need to be taken to formalize goals and standards, and additional controls need to be implemented to ensure the accuracy of the MIS.

Overall, the ISP has made significant progress - especially at the CSC Central Site. The CSC Central Site presently has 145 full-time and 35 temporary employees under the direct line authority of the ISP Manager. Unfortunately, the same degree of progress

² The Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685.

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has not been made in completing the claims assigned to Small Business/Self-Employed (SB/SE) personnel in the field.

Results

Some improvements have been made to the ISP.

Since our earlier review, the IRS has made improvements to the ISP that include the following:

- Accurately date stamping and recording received dates on claims.
- Properly receiving, controlling and shipping returns from the CSC Central Site to field office examiners.
- Designing a computer application to enhance the quality of work and speed up the determinations on claims at the CSC Central Site.
- Developing an automated system of reporting data from the Innocent Spouse Tracking System (ISTS) for use by all managers.
- Updating features on the ISTS that simplify input and improve the quality of data.
- Refining the model used to project future inventory levels. This has had to be done several times to compensate for increased claim receipts and decreased closures.

The IRS has not fully implemented proposed corrective actions.

While the IRS has made improvements to the ISP, management had not yet fully implemented the corrective actions to our previously issued report. Management still needs to formalize comprehensive program goals and standards to fully measure and report accomplishments of the program. Also, the ISTS, while improved, needs additional controls to ensure that it was properly implemented. This is particularly true in SB/SE field units that are not under the direct control of the ISP Manager.

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A Comprehensive Set of Goals and Standards Has Not Been Formalized and Developed for the Innocent Spouse Program

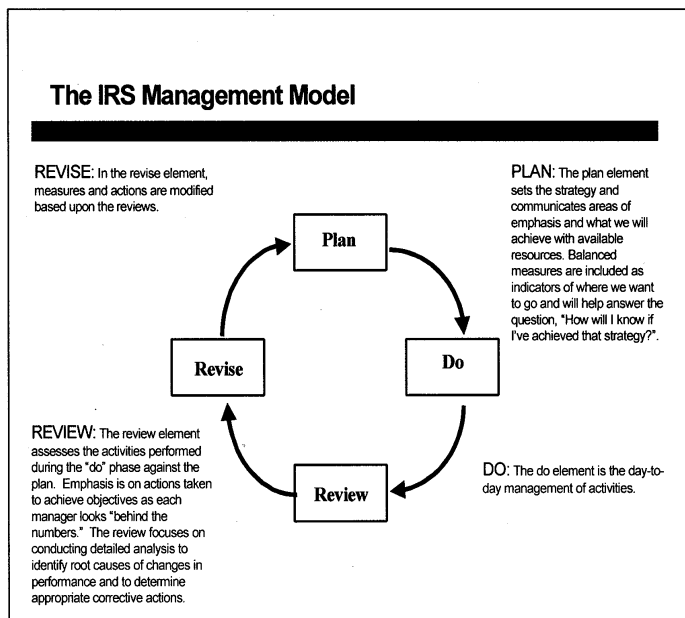
IRS management is responsible for establishing, communicating and maintaining program goals and standards, and monitoring and measuring program accomplishments against those goals and standards. The mission of the ISP includes ensuring that each claim receives timely and consistent treatment, and that work be done correctly and accurately. The program has developed estimates of the number of claims that will be closed during a year, how long claims should stay in the various steps of processing, and the staff resources to be applied to the program.

However, management has not placed enough emphasis on setting goals and standards for the ISP. This information is not consolidated into one document, such as an annual program letter, as used by most other IRS functions and programs. Some ISP goals and standards are not specific, and measurement techniques are not clearly identified.

The importance of goals, standards, and management information has recently been emphasized in the IRS *Management Control Accountability Program: MCAP Handbook for Managers*, published in February 2001. Included is the IRS Management Model that is designed to ensure effective management and protection of assets.

The following diagram illustrates the model.

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Source: *Management Control Accountability Program: MCAP Handbook for Managers*, February 2001

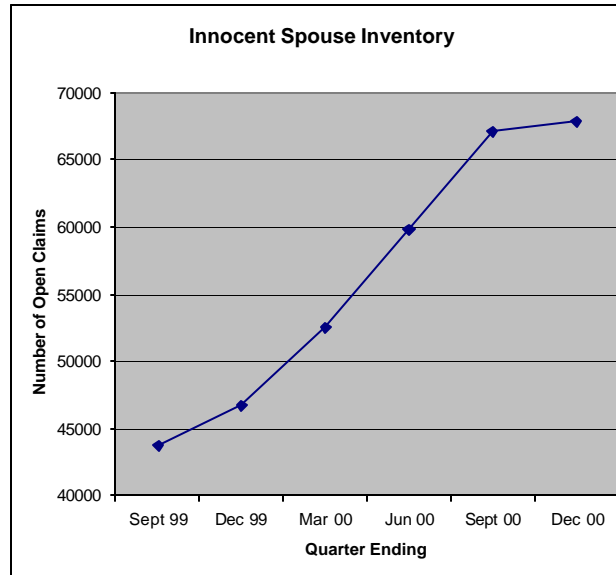
We believe that formalizing goals, standards, and measurement techniques will bring the ISP more in line with the IRS Management Model. Not having adequate goals and standards has made it difficult to properly manage the ISP.

The number of claims in open inventory continues to rise.

The effects of not having comprehensive goals and standards for the ISP can be seen in the inventory of claims for relief. Since the RRA 98 liberalized the innocent spouse provisions, receipts of claims for relief have increased dramatically and continue to exceed projections. The ISP Manager stated that they were making progress on reducing the number of taxpayers who have not yet been notified of the disposition of their claim. However, as of December 24, 2000, there were 66,741 claims for relief in open inventory. This is a significant increase over the approximately 46,000 claims in open inventory as of December 31, 1999.

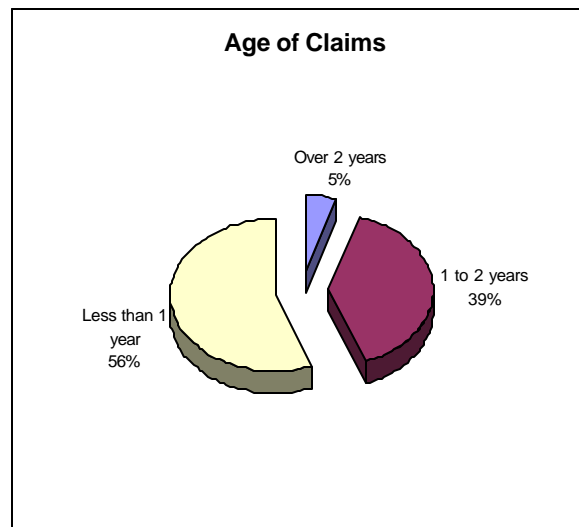
The following chart tracks the inventory growth.

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Source: Innocent Spouse Tracking System

In addition to the number of claims getting larger, the claims are remaining in inventory longer. The following chart shows that 39 percent of the claims had been in inventory between 1 and 2 years and 5 percent had been in inventory over 2 years, as of December 24, 2000.



Source: Innocent Spouse Tracking System

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The ISP Manager does not have direct control over SB/SE resources used to evaluate claims.

In addition to the lack of comprehensive goals and standards, we believe that the organizational structure of the ISP complicates the role of the ISP Manager. Both the Program Manager and the staff at the CSC Central Site are part of the Wage and Investment (W&I) business unit. The Program Manager has direct control over the CSC Central Site staff. However, none of the field examiners assigned to work claims that require field contact (for instance, face to face contact with taxpayers or coordination with other IRS functions) are under the direct control of the ISP Manager. Instead, they are part of the SB/SE business unit.

As a result, it is difficult to properly manage the ISP. Significant inventory backlogs continue, program resources may not be properly directed, program accomplishments may not be accurately measured, and program results may not be accurately reported to the IRS Commissioner and to the Congress.

Interest continues to accrue while claims are being processed.

At the same time, taxpayers' total liabilities are increased because penalties and interest continue to accrue while the claim is being considered. The longer it takes to work the claim, the greater the accumulation of penalties and interest on the tax liability. If a claim is ultimately denied, collection actions are reactivated on a tax liability that is larger than before the claim was filed. Even when relief is granted to one spouse, the other spouse is still liable for the resulting larger tax liability.

Formalizing the goals and standards should help identify the claims that have been in inventory too long and specific actions that can be taken to finalize the resolution of the claims. Specifically, the goals and standards should help complete the processing of the 66,741 claims in open inventory and minimize the time needed to process future claims received.

At the time of our audit, the IRS did not have a definition of overage claims or an action plan to deal with claims that reached an overage status. Since then, IRS management has informed TIGTA that W&I is collaborating with SB/SE to consider initiatives to reduce the backlog of claims in the stage of processing

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known as local review, and to determine more efficient ways to address inventories. In March 2001, management defined aging criteria for each of the claim processing stages. This new procedure will include monthly reports and require feedback on each claim exceeding the aging criteria.

Recommendation

1. In addition to the corrective actions already taken, the IRS needs an annual program letter for the ISP that will formalize a comprehensive set of goals and standards to direct program resources, and establish criteria to measure program accomplishments. These goals, standards, and criteria could then be used to evaluate and report program results. Specifically, these would address factors such as the target inventory level for innocent spouse claims, a definition of overage claims that have been in the system too long, an acceptable level of overage cases, the number and type of resources needed to achieve these goals, and actions to be taken if these goals are not met. Because the program is comprised of two separate and distinct business units, it may be wise to establish two sets of goals and standards, one for the CSC Central Site and one for field SB/SE operations.

Management's Response: The W&I Division Strategy and Program Plans contain goals and measures for personnel resources applied and determinations made for innocent spouse claims. Target levels of pre- and post-determination inventories are a fundamental part of developing these goals and measures. The IRS is committed to monitoring these inventories using the current system process operating data from the ISTS. It will use this data to benchmark improvement of current processes against the "best case scenarios" it currently uses in the planning model. This will tie process improvement to the same inventory model used to set goals in the Strategy and Program Plans. The IRS will evaluate and revise these standards semiannually.

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Small Business/Self-Employed Field Personnel Have Not Properly Implemented the Innocent Spouse Tracking System

Management is responsible for implementing a comprehensive set of internal controls. The ISTS is the primary management information system for the ISP. It is a database of all innocent spouse claims that have been received and processed by the IRS.

Designated personnel in each local IRS office that processes innocent spouse claims are responsible for updating and maintaining ISTS data on the claims assigned to that office. Our review showed that personnel at the CSC Central Site did a good job of maintaining the ISTS and managers used ISTS data. We also confirmed that the ISTS accurately reflects the total claims received. However, SB/SE personnel in field offices did not timely or accurately update the ISTS.

The ISTS did not show the accurate status for claims assigned to field examiners.

Our review of 250 innocent spouse claims randomly sampled from the ISTS in 5 locations clearly showed the inaccuracies in the inventory data. We determined that 49 claims (20 percent) were either not properly updated in the ISTS, or were not accurately reflected in reports generated from the ISTS. Most of the errors (45 of 49) occurred on claims assigned to field offices.

Fifteen of the claims were not properly reflected in reports generated from data in the ISTS, primarily due to data input errors that could not be properly interpreted by the computer program used to generate the reports. The other 34 claims simply had not been updated when the claim moved to the next stage in processing. Two months after our field tests, research showed that 24 of these 34 still had not been updated. These claims had been in the wrong processing stage in the database anywhere from 104 to 585 days.

Several factors contributed to the inaccuracies in the ISTS. First, inventory controls did not require field managers to report the results of validations to the ISP Manager. Second, the inventory controls that had been

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Field Offices responsible for working Innocent Spouse Claims did not consistently conduct monthly inventory validations.

developed were not properly implemented. Third, SB/SE field managers relied primarily on traditional IRS Examination inventory controls such as the Audit Information Management System (AIMS) and the Examination Return Control System (ERCS) instead of the ISTS.

All three of these factors are strongly influenced by a previously mentioned concern with the organizational structure of the ISP. The SB/SE examiners operate under a “Memorandum of Understanding” (MOU) between W&I and SB/SE. The MOU states that the responsibility of SB/SE innocent spouse coordinators includes “maintaining the Innocent Spouse Tracking System (ISTS) database, and validating inventories monthly.” Unfortunately there was no control that required the field to report the results of the validations. As a result, the ISP Manager was not aware that the monthly validations were not being conducted. Management has informed TIGTA that as of March 2001, reports on the monthly validations will be required to be reported to the ISP office.

Field managers rely more on the AIMS than the ISTS. Local SBSE offices are also required by IRS procedures to control innocent spouse claims on the AIMS as well as the ISTS. These offices control innocent spouse claims the same as regular tax audits, including using the AIMS as the primary control database, instead of the ISTS. Some question the need for the ISTS at all. We believe that SB/SE field managers are much more comfortable with the AIMS. Consequently, it has not been a priority for SB/SE personnel to maintain the accuracy of the ISTS.

As a result, the ISTS did not provide accurate information on the status and location of claims, and SB/SE managers did not use the ISTS to effectively manage inventory and resources. Also, the ISP Manager did not receive accurate information to update the inventory model, or to evaluate and report program results to the IRS Commissioner and to the Congress.

Actions to Develop Goals and Standards and Upgrade the Management Information System for the Innocent Spouse Program Have Not Been Fully Implemented

Recommendation

2. Management needs to improve the inventory controls over Innocent Spouse claims for relief. Specifically, ISP management needs to develop uniform procedures to update and validate the ISTS that include criteria for identifying inventory inaccuracies, making necessary corrections, and forwarding the results to the ISP Manager. The new requirement implemented in March 2001 partially addresses this recommendation. Management still needs to ensure that the various offices utilize uniform validation methods and make all necessary corrections.

Management's Response: The Project Office, in partnership with SB/SE and the CSC Central Site, will provide specific guidance for conducting inventory validations in the multi-functional Innocent Spouse section of the Internal Revenue Manual. In addition, the IRS made the computer-based ISTS training universally and easily available for download from the W&I Electronic Learning System.

Conclusion

The ISP was not prepared to timely and accurately process the increased volume of claims for relief after the RRA 98 was passed. Even though great improvements had been made at the CSC Central Site, significant problems continued to exist in managing the SB/SE resources that evaluate the claims assigned to the field. As a result, the inventory of open claims continues to grow and old claims remain in inventory for extended periods of time.

The program continues to lack the fundamental elements of the IRS Management Model. Management needs to take a long-range approach to the program and develop goals and objectives for the ISP as recommended in our earlier report. Also, we believe that the organizational structure of the ISP complicates the role of the ISP

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Manager. The Program Manager has direct line authority over the entire CSC Central Site operation and it has shown great improvement. The Program Manager does not have direct control over the SB/SE resources used to evaluate claims sent to the field and it continues to have problems.

Finally, the ISTS needs to furnish accurate management information. Inventory controls need to be strengthened to ensure that SB/SE field personnel timely and accurately update the status and location of claims assigned to the field.

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Appendix I

Detailed Objective, Scope, and Methodology

As a result of our prior audit report,¹ we conducted this follow-up review to determine if the Internal Revenue Service (IRS) had set goals and standards for managing the inventory of claims for innocent spouse relief and upgraded the management information system.

To accomplish this objective, we:

- I. Determined if controls over the Innocent Spouse Tracking System (ISTS) ensured that it accurately reflected the number, status and location of all innocent spouse claims. Specifically, we:
 - A. Evaluated controls to ensure that innocent spouse claims, received by the IRS on *Request for Innocent Spouse Relief* (Form 8857), were entered into the ISTS timely and accurately. We reviewed a judgmental sample of 30 recently received claims and researched the ISTS at a later date to determine if they had been properly controlled.
 - B. Researched the ISTS for the sample of 30 Forms 8857 received at the Cincinnati Service Center (CSC) to determine if claim processing began immediately, or if there was a delay caused by a backlog of claims still in inventory.
 - C. Reviewed a sample² of 250 innocent spouse claims and researched the ISTS and the Audit Information Management System/Examination Returns Control System to determine whether status updates were timely and accurately updated and recorded in the ISTS as claims progressed through the process.
 - D. Evaluated and compared controls in place at the CSC and the field Examination offices we visited.
 - E. Determined if cases assigned to an examiner matched the case assignment in the ISTS.

¹ *Increased Attention is Needed to Ensure Timely, Accurate Determinations on Innocent Spouse Claims for Relief* (Reference Number 2000-40-063, dated May 18, 2000).

² The sample size of 250 was determined based on the combined population of the five offices visited. We selected 50 from each office by taking an “interval” sample from the current inventory listing of each office as we visited that office.

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- II. Determined if the ISTS provided timely, accurate, and useful information to management. Specifically, we:
 - A. Obtained monthly inventory reports generated for management use.
 - B. Determined if the reports were accurate.
 - C. Determined if management consistently used the reports to validate inventory, assign resources, or otherwise manage the program.
 - D. Determined the status of the automated reports that management planned to distribute to the field and how the field used that data.
- III. Determined if the inventory model developed by Innocent Spouse management was based on sound assumptions and accurate historical data.
 - A. Evaluated whether the “historical” figures used in the model were accurate when compared to ISTS data.
 - B. Determined if the ratios, formulas and assumptions used in the model accurately and fairly reflect past experience based on verified data.
- IV. Determined if the projections resulting from the Inventory Model were obtainable, and if they were accurately communicated to senior IRS management, the Congress and the Treasury Inspector General for Tax Administration. Specifically, we:
 - A. Evaluated whether the IRS will be able to meet the projected inventory levels given that the underlying data is valid and the assumptions are reasonable.
 - B. Determined if senior IRS management is receiving complete data and able to make proper management decisions based on this data.

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Appendix II

Major Contributors to This Report

Walter Arrison, Assistant Inspector General for Audit (Wage and Investment Income Programs)

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Susan Price, Auditor

Cari Robben, Auditor

Gail Yorgason, Auditor

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Appendix III

Report Distribution List

Commissioner N:C
Commissioner, Small Business/Self Employed Business Unit S
Commissioner, Wage and Investment Business Unit W
Innocent Spouse Program Manager W:ISP
Chief Counsel CC
National Taxpayer Advocate TA
Director, Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O
Office of Management Controls N:CFO:F:M

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Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:

- Taxpayer burden –Potential; 66,741 taxpayer accounts impacted; (see page 4).

Methodology Used to Measure the Reported Benefit:

We determined the number of accounts impacted from the number of claims open on the Innocent Spouse Tracking System as of December 24, 2000.

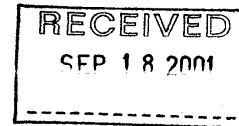
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Appendix V

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308



September 18, 2001

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM:

for
John M. Dalrymple

Commissioner, Wage and Investment Division

SUBJECT:

Draft Report – Actions to Develop Goals and Standards and Upgrade the Management Information System for the Innocent Spouse Program Have Not Been Fully Implemented (200040061)

The Innocent Spouse Program is one of the highest priority programs in the Wage and Investment Division. It is vitally important that taxpayers with tax claims related to spousal issues be given the utmost care and attention. To achieve this goal, the Innocent Spouse Program is placed at the executive level in the Wage and Investment Operating Division and reports directly to me. In addition the program manager and staff is committed to delivering the highest quality of service and to processing and resolving Innocent Spouse tax issues for the general public as quickly as possible. I appreciate the recommendations for improvements contained in your draft report. Your overall summary concludes that although we have made significant progress, we should develop additional goals and standards and strengthen controls over inventory validations. We agree with your recommendations. We will further refine our program measurements and improve our management information system by codifying uniform validation procedures.

Before commenting on the specific recommendations in your report, I would like to address a number of comments in the draft that I believe are misleading and do not accurately describe the status of the Innocent Spouse Program:

Status of Inventory

The report indicated that the inventory had significantly increased to 66,741 claims as of December 24, 2000, as compared to 46,000 claims as of December 31, 1999. Reporting by totals misinforms the reader of the nature of the inventories and masks the progress we made to move claims through the consideration process. We continue to reduce pre-notification inventory despite a gain in receipts.

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We consistently measure and report our inventory on a basis of whether we have notified the taxpayer of our determination. We believe this is an important measure of our service to taxpayers. Once a claim moves to the notification stage, certain statutory and processing timeframes and the appeals process must expire before we can move the claim final closure. The relevant measurement of inventory is what claims have been worked and what claims remain, not the total claims on hand. Many claims, for all practical purposes, are out of our control.

The total number of claims in various post-notification categories, some of which are statutory and some of which are at the claimant's request, will ultimately decrease when the statutory time specified in the legislation and timeframes for claimants to exercise certain rights expire. The IRS does not have the authority to ignore these timeframes.

Consistent with this concept, we measure our inventory as pre-notification and post-notification. The number of taxpayers who have not been notified of the disposition of their claim has decreased as follows:

Pre-Notifications Claims in Inventory

<u>12/31/99</u>	<u>12/31/00</u>	<u>7/29/01</u>
38,929	37,929	33,442

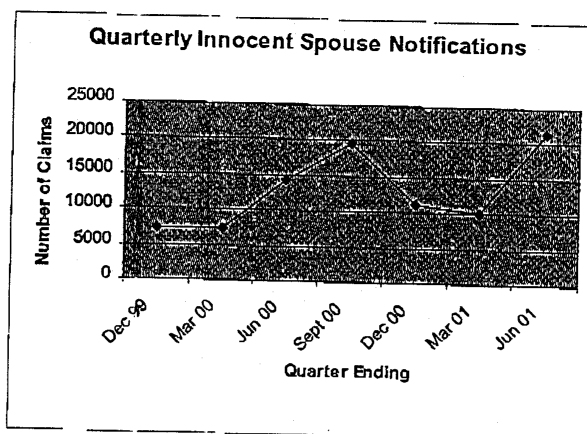
We reduced this inventory 14 percent from December 31, 1999, to July 29, 2001, despite the fact we just completed our peak receipts season. We expect this downward trend to continue.

In addition to inventory reduction activities, the mix of the inventory is also very important. For example, the 66,741 claims for relief shown as open on December 24, 2000, includes 3,310 claims in centralized review. These are claims that have been through every stage in the system. While we agree the base period you used also contains claims in centralized review, the number in that stage on December 29, 2000, was 3,116 claims greater than on December 31, 1999.

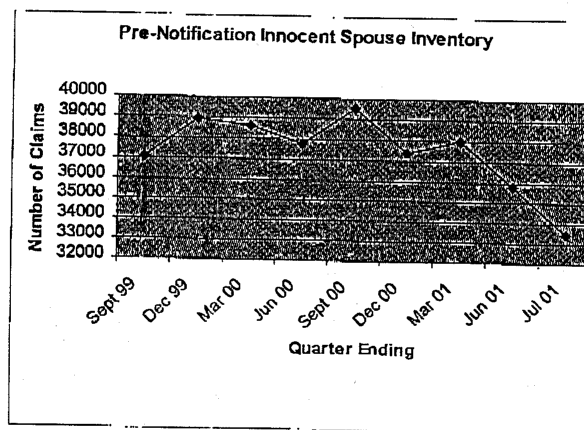
Although our receipts increased by 22 percent in FY 2000, the following graphs show notifications have increased and the pre-notification inventory has decreased. Also, the processing timeframes in general have decreased. We have achieved this through initiatives to reduce inventory levels and provide a quicker turnaround on claims.

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Source: Innocent Spouse Tracking System



Source: Innocent Spouse Tracking System
Includes Stages 1-6, 8 & 10

Age of Inventory

The report shows that the claims are staying in inventory longer, with 39 percent of the claims in inventory between 1 and 2 years, and 5 percent in inventory longer than 2 years. We do not know what base period you are using to determine that claims are staying in inventory longer.

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In a best-case scenario, it takes a denied, non-petitioned claim 304 days to go through the entire claims process. While we have not achieved optimal processing, given a best case scenario of 304 days, it is not surprising that 39 percent of the *total* inventory is between 1 and 2 years old.

We acknowledge some old claims in the system need attention. However, the data below shows the actual processing times for claims received and disposed in FY 2000 is improving since the inception of the Innocent Spouse legislation.

Innocent Spouse Claims Processing Time		
Type of Determination	Full History Receipts	FY 2000 Receipts
	Days To Process	Days To Process
Basic Reg. Not Met Claims	139	80
Merit Claims	318	238

Increase in Tax Liability Due to Processing Delays

The report states that taxpayers' total liabilities are increased because penalties and interest continue to accrue while we consider the claim; the longer it takes to work the claim, the greater the resulting tax liability. It also states that even when we grant relief to one spouse, the other spouse is still liable for the resulting larger tax liability. Unpaid liabilities continue to accrue penalties and interest, by law. This fact does not only apply to the innocent spouse provisions. For many claims, the failure to pay penalty has reached the maximum limit by the time the IRS receives a claim, so there would be no increase in that penalty because of our delay in processing the claim.

For requesting spouses who get total relief (41 percent of the claims that meet basic requirements and receive a determination), no increase in penalties and interest accrue. The time a claim is in process has no impact on additional penalties and interest to the requesting spouse. Also, the time we require to determine the allowability of the requesting spouse's claim (unless the requesting spouse receives a refund) does not impact the liability of the non-requesting spouse. The non-requesting spouse always did, and always will, owe the total joint liability until paid or the collection statute of limitation expires. The non-requesting spouse has the responsibility and opportunity to pay the outstanding liability at any time.

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IRS Management Model

We used the IRS Management Model to establish Innocent Spouse Program FTE and Unit goals for FYs 2000, 2001, 2002, and 2003. We based these goals on detailed computations, and used them to monitor program progress.

Commissioner Rossotti uses these goals to advise the Senate Finance Committee of our accomplishments in the Innocent Spouse Program.

For example, we used our Management Model to address the increasing receipts and inventories at the centralized site. We established an initiative in October 2000 to increase the staffing and attain a manageable inventory by September 30, 2001. Based on updated assumptions and actual experience, we revised this estimate in March of 2001, hired and trained additional staffing, and revised our goals.

We constantly analyzed data and made changes to practices and procedures. Tighter management controls such as reporting various program accomplishments (overage, etc.) weekly or monthly as suggested in your report, may have assisted in reducing the number of aged cases. However, we do not believe this is a basis for concluding we failed to follow the principles of the Management Model because the actions described above at a macro level are exactly what the Management Model prescribes.

SB/SE's Involvement in Innocent Spouse Program

Since the audit work concluded on this review, we have implemented many initiatives that will positively impact on the Innocent Spouse Program. Our effort should eliminate some of your concerns with SB/SE's involvement in the Innocent Spouse Program:

- SB/SE has assigned responsibility for Innocent Spouse to an additional director and two analysts within their operation. They work closely with the Innocent Spouse Project Office to administer the Innocent Spouse Program.
- We have refined the criteria for sending work to SB/SE with a goal of maximizing the number of cases worked at the centralized site in Cincinnati.
- We have given 27 Tax Resolution Representatives (TRRs) within W&I Innocent Spouse training. We assigned inventories to them before training other TRRs within W&I to do Innocent Spouse work during the non-filing season, thereby relieving SE/SE of workload.

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- SB/SE has redirected the Examination Quality Management System (EQMS) reviewers previously trained in the Innocent Spouse Program to assist the Centralized Innocent Spouse Review operation in Atlanta to become more current.
- SB/SE has also redirected and trained additional EQMS reviewers to assist with the elimination of backlogs of cases in SB/SE local review.
- We are currently studying the need to continue 100 percent local review of SB/SE's allowed claims. The goal is to divert the FTEs to determination work, thereby reducing SB/SE's inventories and aged cases.
- We have established additional senior claims examiner positions at the centralized site in Cincinnati and provided additional training to handle the increased complexity of the workload at Cincinnati.
- We are moving the Centralized Innocent Spouse Case Review in Atlanta to Cincinnati effective October 10, 2001, thereby relieving SB/SE of the responsibility of performing the sample review of Innocent Spouse cases.
- We have approved a revised management and staffing structure at the centralized site to accommodate the above changes.

Correction to Innocent Spouse Tracking System (ISTS) Validation

The report mentions that a new procedure will include monthly reports and require feedback on each claim exceeding the aging criteria. After establishing this control, we determined a monthly frequency is excessive and changed the frequency to bi-monthly. The referenced report is in addition to the monthly inventory report and query capability is available to management and Innocent Spouse Coordinators.

Our comments on the specific recommendations in your report are as follows:

Recommendation #1

In addition to the corrective actions already taken, the IRS needs an annual program letter for the Innocent Spouse Program that will formalize a comprehensive set of goals and standards to direct program resources, and establish criteria to measure program accomplishments.

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Assessment of Causes

Due to the volume of claims received and the legal and procedural complexity of the IRC 6015 provisions, the processes implemented were in a dynamic state during the period July 1999 through September 2000. The primary focus of the IRS' effort during this time was to gain control of the workload, understand the legislation, and properly train our workforce.

Corrective Actions

We eliminated the practice of issuing functional program letters with the initiation of the current Strategic Planning Process employed by the IRS. Each business division develops a Strategy and Program Plan that supports the agency wide strategic plan. The Wage and Investment Division Strategy and Program Plans for FY 2000-FY 2002 and FY2001-FY 2003 contain goals and measures for FTEs applied and determinations made for Innocent Spouse claims. Target levels of pre- and post-determination inventories are a fundamental part of developing these goals and measures.

In keeping with the spirit of the Revenue and Restructuring Act of 1998 (RRA 98), the IRS is committed to treating taxpayers properly rather than meeting statistical goals. With that vision, we are committed to monitoring our pre- and post-notification inventories using the current system process operating data from the ISTS. We will use this data to benchmark our improvement of current processes against the "best case scenarios" we currently use in the planning model. This will tie process improvement to the same inventory model we used to set goals in the Strategy and Program Plans. We will communicate strategies to drive improvement in the age and level of claims in inventory to appropriate management levels and the Project Office will monitor progress quarterly. We will evaluate and revise these standards semiannually, at the same time we update the inventory model.

Implementation Dates

March 2002

Responsible Officials

Jack G. Holstein
Innocent Spouse Project Manager

Corrective Action Monitoring Plan

Quarterly with semi-annual updates to standards.

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Recommendation #2

Management needs to improve the inventory controls over Innocent Spouse claims for relief. Specifically, ISP management needs to develop uniform procedures to update and validate the ISTS that include criteria for identifying inaccuracies, making necessary corrections, and forwarding the results to the Innocent Spouse Program manager. Management still needs to ensure that the various offices utilize uniform validation methods and make all necessary corrections.

Assessment of Cause

Various memoranda and topics presented at Innocent Spouse Coordinator meetings (September 1999, January 2000, and May 2000) provide guidance on how to conduct inventory validations. Since the conclusion of TIGTA's on-site audit work, the accuracy of the ISTS inventory has shown continued improvement. We have initiated bi-monthly aging reports that require reporting to the Project Office on actions taken. However, no codification of these procedures is in the Internal Revenue Manual.

Although we developed a reference guide and computer-based training module to help employees learn the ISTS, the training was not easily accessible.

Corrective Actions

The Project Office, in partnership with SB/SE and the Cincinnati Centralized Site, will provide specific guidance for conducting inventory validations in the multi-functional Innocent Spouse section of the Internal Revenue Manual. We will discuss this subject at the October 2001, Innocent Spouse Coordinator meeting.

We made the computer-based ISTS training universally and easily available for download from the Wage and Investment Electronic Learning System.

Implementation Dates

Currently	W&I Electronic Learning System Training for ISTS
October 2001	IS Coordinator Meeting
December 2001	Draft IRM guidance
March 2002	Final IRM published guidance

Responsible Officials

Jack G. Holstein
Innocent Spouse Project Manager

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Corrective Action Monitoring Plan

The Project Office will sample review the bi-monthly aged inventory listings after we have worked them and provide feedback to SB/SE and the Cincinnati Centralized Site management beginning in October 2001.

If you have any questions or need additional information, please contact Jack G. Holstein, Innocent Spouse Project Manager, at (202) 622-6966 or (919) 471-9861.